RHODE ISLAND PUBLIC UTILITIES COMMISION

IN THE MATTER OF NATIONAL GRID'S	**:**	
STANDARD OFFER PORTFOLIO	**:**	**Docket No. 4041**
PROCUREMENT PLAN FOR 2010	**:**	
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**POSITION STATEMENT OF
CONSTELLATION ENERGY COMMODITIES GROUP, INC.
AND CONSTELLATION NEWENERGY, INC.
REGARDING NATIONAL GRID'S ACCELERATED STANDARD OFFER
PROCUREMENT PLAN PROPOSAL**

I. INTRODUCTION

Pursuant to the schedule adopted in the April 7, 2009 Memorandum to the parties, Constellation Energy Commodities Group, Inc. ("CCG") and Constellation NewEnergy, Inc. ("CNE") (collectively, "Constellation") hereby submit their Position Statement regarding the Accelerated Standard Offer Procurement Plan proposal The Narragansett Electric Company d/b/a National Grid ("National Grid") submitted in this proceeding.

The initial phase of this proceeding is an extremely truncated review of Grid's proposed procurement strategy for the Small Customer Group load, mainly residential, small commercial and street lighting customers. Constellation understands the desire to take advantage of current favorable market conditions in order to hedge these customers against potential rate instability. Constellation does not take issue with the use of financial hedges; however, Constellation does have concerns with the manner in which the hedges are incorporated into Grid's overall procurement strategy. It is inappropriate to use the cover of an expedited schedule to make a policy determination as important as moving to an actively managed portfolio. The Commission should reject any attempt to do so, and clearly state that its determinations in this accelerated proceeding are limited based upon the unique facts and circumstances associated with this filing.

If the Commission determines it is interested in investigating the merits of managed portfolio versus full requirements, then it should initiate a proceeding in which a full and robust record can be created detailing the pros and cons of such a structure.

CONSTELLATION POSITION STATEMENT

CCG is a power marketer authorized by the Federal Energy Regulatory Commission ("FERC") to sell energy and capacity and certain ancillary services at market-based rates.[1] CCG focuses on serving the full requirements power needs of distribution utilities, co-ops and municipalities that competitively source their load requirements. CCG currently provides SOS supply to National Grid in Rhode Island.

CNE is a retail electricity supplier that provides customized energy solutions and comprehensive energy services to commercial and industrial customers. CNE has been certified to act as a competitive retail electric supplier to serve customers located within various service territories throughout the United States and Canada, including in Rhode Island, and has been granted market-based rate authority by FERC.[2] Nationwide, CNE has more than 15,000 MW of load under contract with more than 10,000 retail customers, some of which are in the District of Columbia.

Constellation's Position Statement covers two related but separate issues. The first section will address the appropriateness of the suggestion by Grid in its Accelerated Procurement Plan as well as in several data responses that the two financial hedges that Grid proposes would allow it to "transition to a managed portfolio for procurement of standard offer service." It will also outline some of the factors that must be carefully considered before such change in policy

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1 *See Constellation Power Source, Inc.*, 79 FERC ¶ 61,167 (1997) (order initially granting CCG market-based rate authority).

2 *See NEV, L.L.C.*, 81 FERC ¶ 61,186 (1997) (order initially granting CNE market-based rate authority).

can occur. The second section will include some specific recommendations for improving the financial hedges that Grid has proposed.

I. The Commission should Reject Any Attempt to Use This Expedited Proceeding to Modify National Grid's Procurement Plan from a Full-Requirements Procurement Structure to an Actively Managed Portfolio

Constellation respects the Commission's desire to restrict this phase of the proceeding to consideration of only Grid's Accelerated Procurement Plan to enter into two near-term financial hedges in order to take advantage of historically low market prices. While Constellation believes Grid should not be engaged in market speculation, it does see some merit in the plan that Grid has put forward. However, in Grid's repeated reference to these proposed hedges serving as a first step towards a transition to a managed portfolio, Grid has effectually expanded the scope of this phase of the proceeding. Not only is this action entirely unsupported by evidence that a managed portfolio would best serve Rhode Island Standard Offer Service ("SOS") customers, its inclusion into this phase of the proceeding under the proposed accelerated schedule provides little to no opportunity for parties to respond and fully vet the impact of such a dramatic change in procurement strategy. Therefore, Constellation urges the Commission, if it so chooses to approve the Accelerated Procurement Plan by Grid, to also make clear that the approval should be treated as a stand-alone decision and that the approval should not be interpreted as an endorsement of a move away from the full-requirements ("FR") procurement structure to that of a utility managed portfolio. Since Grid has already introduced this concept into its Accelerated Procurement Plan, Constellation is compelled to offer the following general comments on FR supply as compared to managed portfolios.

a. Grid's March 9, 2009 FR Procurement structure is the appropriate method for serving the Small Customer Group load.

Constellation urges the Commission to reject any suggestion by Grid or any other party to use this expedited proceeding as a means of transiting away from the FR procurement structure to an *actively* managed portfolio of resources. The implications of such a change in policy are vast, making such a dramatic change within the context of an expedited schedule a dangerous course.

Rather, for purposes of the Small Customer Group load in the context of this expedited proceeding, Constellation would support the FR procurement structure Grid originally proposed in its March 3, 2009[3] filing in this proceeding. This FR procurement structure is, in fact, a method of Portfolio Management in which procuring a portfolio of FR resources through a competitive request for portfolio ("RFP") process relieves Grid from active management responsibility as well as risk exposure.

The FR procurement process provides a proper balance between obtaining the most competitive prices for consumers and maintaining a reasonable level of price stability from year-to-year. The FR proposed in Grid's March 3 Filing would result in prices that are reflective of the market, while still insulating customers from potential volatility. Moreover, requiring Grid to retain personnel or hire outside consultants and expend resources to actively manage an energy portfolio by making shorter- and longer-term purchases is an inefficient way to achieve competitive SOS prices for consumers. As Grid's load must always be met with full requirements products, in order to actively manage its load obligations, Grid (or its consultants) would have to retain individual experts who understand and follow not only electric energy and other commodity markets, but also ancillary services, capacity and renewable products markets.

[3] Constellation understands that Grid will shortly file revisions to this structure to account for long-term renewable contracts pursuant to the Commission's directives. Constellation's position herein is exclusive of these revisions, as it will not be in a position to opine on them until they are filed and fully reviewed.

A diverse pool of wholesale suppliers – rather than a small group of independent consultants or utility employees – provide the most cost-effective method of SOS supply management for utility load. Wholesale suppliers are experts in the area of portfolio management, and have greater resources, expertise and ability to appropriately manage portfolios of supply at the least possible cost, by allocating the costs for their operations over much larger load obligations throughout the country. These wholesale suppliers pass on the savings they achieve due to their sophisticated risk management skills in the form of more competitive bids for full requirements SOS products in the SOS RFPs. Wholesale suppliers have already and will continue to significantly invest in acquiring experts and programming in each specific type of market that make up full requirements SOS supply.

For instance, at Constellation, hundreds of employees are involved in the process of providing full requirements service to utilities and customers around the country. Constellation employs a team of seasoned portfolio managers that manages large regional portfolios for serving Constellation's customers' full requirements loads. Constellation must ensure that it properly and fully accounts for any transaction that goes into its portfolio, and that requirements for the entire load are met continuously for every hour of every day of every week. A team of 'strategists' continuously develops and improves computer models to keep track of all of the variable inputs that go into providing full requirements service; these strategists provide and analyze various scenarios that Constellation's portfolio managers may face. In addition, a 'fundamentals' group constantly researches basic supply and demand in fuel and power markets in order to monitor macroeconomic trends that affect the costs of serving load. Full-time meteorologists on Constellation's team continually monitor and predict the weather, so that Constellation's team can plan for weather effects on load requirements, and adjust supply accordingly. A 24-hour power trading desk trades power in the hour ahead, day ahead, and week ahead markets each day of the week, in order to help manage Constellation's supply portfolio. Moreover, power managers and traders monitor and trade in not only ISO-NE's market, but also those in Canada, New York, PJM, and other markets throughout the U.S.; fuel managers do the same as fuel markets have direct effects on power markets. Similar resources focus on fuel oil, currency, emissions and renewable energy markets. The task of meeting full requirements load supply additionally requires controllers, schedulers and dispatchers. Supporting all of these operations is a team of regulatory specialists and attorneys that monitor and participate in regulatory and legal activities which affect energy markets.

The expertise that such a team of employees as that assembled at Constellation, and their advanced programs and systems, drives costs down by utilizing a well-developed infrastructure and spreading the overhead for such activities across Constellation's entire portfolio, in this way producing a far better result than a small team of people at a regulated utility company or its consultant. The costs for providing such service for Grid's customers is highly constrained by the very competitive nature of this business, because sophisticated wholesale suppliers throughout the market have operations similar in structure to those of Constellation, and compete through the RFPs to serve Grid's SOS load at the lowest cost.

b. Active portfolio management imposes vast regulatory issues and drains the resources of the Commission, the utility and other parties.

Finally, a move to active portfolio management would raise a host of regulatory oversight and prudence issues that are not present under the current RFP approach. The Commission has an obligation to ensure that Grid has acted prudently in procuring its SOS obligations. Whereas under a RFP approach the Commission can be assured that Grid has acted prudently by choosing the lowest-cost suppliers through a well-designed, standard competitive procurement, under a

Portfolio Management approach, the Commission by necessity may have to conduct an after-the-fact review to determine the prudence of Grid's various trading practices and actions. Such a review would require a tremendous amount of data, and would take a significant amount of the Commission's and parties' time and resources. Because the utility may face a risk of after-the-fact disallowances of certain portfolio costs on the grounds of imprudence, it may be reluctant to develop and take advantage of more complicated risk strategies to mitigate its portfolio risks. In addition, under a Portfolio Management approach, Grid's suppliers and lenders – cognizant of the potential for after-the-fact disallowances – may be more likely to charge premiums to Grid (and, in turn, its SOS customers) due to concerns regarding the utility's creditworthiness.

In summary, it is best to allocate to wholesale suppliers – rather than Grid and, in turn, the SOS consumers – the risks and responsibilities associated with active portfolio management. Wholesale suppliers who submit bids in the SOS RFPs are in the best position and are best equipped to bear such risks and responsibilities.

II. Recommended Improvements to Financial Hedges Procurement Plan

As stated previously, the Commission should consider decisions about procurement of products such as financial hedges within the context of a broader procurement strategy, as proper consideration may not be given within the accelerated schedule of this phase of the proceeding. However, addressing the specific details of the Accelerated Procurement Plan that Grid has put forward, Constellation has several recommended improvements to the plan.

1. **NYMEX** - Grid proposes to index the financial hedges to NYMEX. Constellation would note that NYMEX is one of several exchanges for NEPOOL power, and it is not widely used to settle financial swaps by the suppliers that are likely to respond to Grid's solicitation. Therefore, there is likely to be a premium charge for such a specialized product.

2. **Shaped Product** - Grid proposes a shaped financial product that includes volumes that vary by month. If NYMEX is to be used as the settling index for the proposed hedge transactions, the monthly volumes must be consistent with NYMEX's structure, which can combine certain months such as March and April as a single price.
3. **Settlement Schedule** – Grid proposes a somewhat unique settlement process in which it would "unwind" the hedges at such time that it enters into a full-requirements supply contract. Financial swaps generally settle a single month at a time after the delivery month. The risk of suppliers having to pay cash for the market move on the entire term position at a specific point in time, prior to start of the actual term, may result in an additional premium.

Constellation recommends the adoption of an alternative hedging structure, which would eliminate these problems while still allowing Grid to achieve its hedging objectives. A more efficient way to structure the hedges would be to have Grid sell the hedges simultaneously with the full-requirements physical supply procurement, similar to the way resources are procured with full-requirements physical supply in the state of Maine. By doing this, Grid would realize several benefits, including the avoidance of double charges for hedge costs, potentially diversifying Grid's credit exposure (assuming swap and full requirements counterparties are separate entities), and enhancing competition for the full-requirements solicitation by virtue of reducing the commodity risk position of the full-requirements obligation with the associated Energy hedges.

Constellation would also suggest modifications to the credit terms that Grid proposed. The structure that Grid has proposed is often referred to as "one-way margining." Under this structure, when market prices rise above the price set by the hedge, the hedge supply is required to post credit for the difference between the hedge price and the market price. By doing so, the purchaser of the hedge is protected should the supplier default on the contract. This type of requirement is appropriate to insure that rate payers are properly protected. However, under one-way margining, when market prices drop below the hedge price there is no requirement for the purchaser to post credit for the difference. Under this asymmetric structure, the hedge supplier must build in a risk premium to its price, resulting in higher prices for customers. Constellation is aware of several New England utilities that have accepted standard Edison Electric Institute master agreements that include two-way margining. Changing the credit requirements from one-way to two-way margining would have the effect of reducing hedge prices for customers while exposing them to no additional risk.

Finally, if the Commission were to direct Grid to incorporate the changes to their financial hedges as Constellation recommends in these comments, Grid would be able to refile its Accelerated Procurement Plan within two weeks. A two-week delay in the release of the financial hedges solicitations should have no impact on Grid's ability to lock in lower market prices for the Small Customer Group.

CONCLUSION

Although Constellation has no major objections to the financial hedges proposed by Grid in its Accelerated Procurement Plan, and has recommended just a few modest changes to the proposed structures of the hedges, we maintain that the suggestion of Grid and other parties that this Plan represents a first step towards the transition to a managed portfolio is entirely unsupported and is an issue that is more appropriately addressed in a separate proceeding.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I certify that I have served the aforesaid Position Statement on those listed on the attached service list this 24th day of April, 2009.

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Docket No. 4041 National Grid – SOS and RES Procurement Plans
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